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No. ..-...

IN THE

Supreme Court of the United States

October Term, 1982

TIRSO DEL JUNCO, WALTER L. RASIC, ANDRES ALONZO, JR., C.V. HOLDER, MARTIN CASTILLO, GRACE C. QUINN, ANTONIO E. VALLE, GILBERT R. VASQUES, HAL W. BROWN, JR.,

Petitioners,

vs.

C.T. CONOVER, Comptroller of the Currency, Office of the Comptroller of the Currency, Department of the Treasury,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

PETITION FOR CERTIORARI.

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Petitioners,

vs.

C.T. CONOVER, Comptroller of the Currency, Office of the Comptroller of the Currency, Department of the Treasury,

Respondent.

Questions Presented.

1. Whether national bank directors "knowingly violate 12 U.S.C. §84" within the meaning of 12 U.S.C. §93 absent the directors' knowledge that the approved loans exceeded the bank's lending limit.

2. Whether compliance by such directors with *Corsicana National Bank v. Johnson*, 251 U.S. 68 (1919), precludes the Comptroller of the Currency (Comptroller) from preventing them from mitigating their personal liability under 12 U.S.C. §93 for loans which violate 12 U.S.C. §84.

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C.T. CONOVER, Comptroller of the Currency, Office of the Comptroller of the Currency, Department of the Treasury,

Respondent.

PETITION FOR CERTIORARI.

Opinions Below.

The opinion of the Court of Appeals, the Comptroller's decision and order to cease and desist and the opinion of the Administrative Law Judge are in the Appendix.

Jurisdictional Statement.

The judgment of the Court of Appeals for the Ninth Circuit was entered on July 30, 1982. The jurisdiction of this Court is invoked under 12 U.S.C. §1818(h)(2) and 28 U.S.C. §1254. Petition for Review for the Comptroller's decision was filed in the Ninth Circuit on July 14, 1981.

Statutory Provisions Involved.

12 U.S.C. §84
12 U.S.C. §93
12 U.S.C. §1818
12 C.F.R. §7.1310(c)(3)
15 U.S.C. §631

The pertinent provisions of the statutes involved are set forth in Appendix F.

Statement of Case.

Petitioners were the directors of Los Angeles National Bank (Bank), a two branch, 35 employee national banking association formed in 1973 pursuant to the National Program for Minority Business Enterprises. (15 U.S.C. §631.) Bank's first president and loan officer was James Carpenter ("Carpenter"). From 1973 until April 1979 Carpenter tutored Petitioners in how to review loans. They had no prior bank managing experience and relied on Carpenter and legal counsel in discharging their duties.

On January 12, 1979 Carpenter recommended to Petitioners (except Grace C. Quinn who was not yet a director)[1] that they approve a loan to Rehbock Lewis (Lewis) in the sum of $225,000. The purpose of the loan was for a reloan by Lewis to Fame Furniture (Fame) of which Lewis was president. Based upon Carpenter's recommendations Petitioners approved the loan.

In April 1979 Carpenter left the Bank, leaving Donald F. Jewett ("Jewett"), who had been with the Bank since 1977, as the Bank's only loan officer.

On May 4, 1979 Jewett recommended that Petitioners approve a $225,000 loan to Fame. Before making his recommendation Jewett determined that the loan did not violate 12 U.S.C. §84 which limits lending to a single borrower

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[1]Petitioner Grace Quinn did not become a director until 1979.

in excess of 10% of the Bank's capital stock. Based on Jewett's recommendation Petitioners (except for Hal W. Brown, Jr.) approved this loan.

On June 14, 1979 Jewett, after determining that there was no violation of Section 84, recommended the approval of a loan of $125,000 to Ralph Ware (Ware). The loan was secured with bonds pledged by Lewis. Ware was Fame's secretary and he reloaned the proceeds to Fame. Based on Jewett's recommendation, Petitioners (except for Antonio E. Valle and Gilbert R. Vasques neither of whom attended the board meeting) approved the loan.

On September 28, 1979 Petitioners were notified by the Comptroller, the Respondent in these proceedings, that the Fame and Ware loans violated Section 84.[2] In the notice Petitioners were directed to reduce the two excess loans to conforming amounts.

This was the first notice by Respondent regarding the violation and the remedial action Petitioners were expected to take. Petitioners immediately commenced collection efforts on the loans.

In December 1979 Respondent conducted his regular periodic examination of the Bank. In his Report of Examination dated February 23, 1980, Respondent again requested Petitioners to either eliminate the excess loans or, as an alternative, deposit in an escrow account funds sufficient to reimburse the Bank for an anticipated $193,000 loss. Petitioners elected to continue their collection efforts to eliminate the excess loans. They did not refuse to take any remedial action requested by Respondent. Petitioners directed that Fame's checking account with the Bank be offset and that the proceeds be applied to pay off the Fame loan.

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[2]Respondent aggregated the two loans pursuant to 12 C.F.R. §7.1310(c)(3) with the Lewis loan to establish the violation.

In June 1980 the Bank sold the collateral securing the Ware loan and applied the proceeds to the loan. As of July 1980 the two "excess loans" were repaid in full. In September 1980 Petitioners, as part of a settlement of a complaint filed by Fame in its bankruptcy proceeding, approved a refund of $47,000 of the offset proceeds. This reinstated an unpaid principal balance of $41,000 on the Fame loan.

While Petitioners' collection efforts were ongoing Respondent commenced administrative proceedings to obtain a cease and desist order. Petitioners answered the notice of charges and an Administrative Law Judge (ALJ) was appointed to hear the case. Respondent moved for summary judgment. (App. B, *infra*, pp. 15-16.)

In their answer Petitioners admitted that when they approved the three loans they knew the proceeds of each loan were to be used for the benefit of Fame. On these admissions in deciding the motion for summary judgment, the ALJ ruled that it was proper for Respondent to aggregate the three loans to find that the Fame and Ware loans violated Section 84.[3] He also ruled that an evidentiary hearing would be required for other issues. After such hearing the ALJ recommended that Respondent issue a cease and desist order, that Petitioners should, after applying the loan recoveries to the two excess loans, indemnify the Bank for the outstanding balance remaining on the Fame loan, and that the Bank recover its loan collection costs and the attorneys' fees it paid for Petitioners' defense. (App. B, *infra*, p. 8.)

Respondent agreed with the ALJ's findings but disagreed with the ALJ allowing Petitioners to reduce their liability by the sums received from their efforts to collect the two excess loans. Respondent's decision and order to cease and

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[3]The Lewis loan did not violate Section 84.

desist declared that Petitioners' liability could not be reduced by recoveries on the excess loans until the Lewis loan, which did not violate Section 84, had been fully repaid with interest. (App. C, *infra*, pp. 41-42; App. D.)

Pursuant to 12 U.S.C. §1818(h)(1) Petitioners timely filed a Petition for Review in the Ninth Circuit (App. E, *infra*), which affirmed Respondent's decision and order to cease and desist. The Circuit found that Petitioners intentionally violated Section 84 because they knew the identity of the borrowers, the loan amounts and the bank's lending limits. It also concluded that Respondent could properly require that before Petitioners reduced their personal liability for the excess loans by recoveries made on them, the legal loan to Lewis must be repaid in full with interest. (App. A, *infra*, pp. 9-10.)

REASONS FOR GRANTING WRIT.

The Circuit's affirmance of Respondent's order in effect approved two rules which conflict with the standard and measure of liability established by this Court for national banking association directors who approve loans which violate Section 84.

Circuit's Interpretation of Intentional Violation Standard of 12 U.S.C. §93 Conflicts With Decisions of Supreme Court.

In 1907 this Court declared that before personal liability may be imposed on a director under Section §93 for damages caused by his violation of the National Bank Act (which includes Section 84), it must be established that the director intentionally or knowingly violated the statute. Mere negligence is not sufficient.

> ". . . [T]he statute imposes certain expressed duties and it makes a knowing violation of such commands the test of civil liability, the oath in this regard also conforms to the requirements of the statute by the promise not to 'knowingly violate, or willingly permit to be violated, any of the provisions of this title' . . . [W]here by law a responsibility is made to arise from the violation of a statute knowingly, proof of something more than negligence is required; that is, that the violation must in effect be intentional. . . ."

[*Yates v. Jones National Bank*, 206 U.S. 158, 178, 180 (1907).]

Again in 1919 this Court stated:

> "Under the rule settled by familiar decisions of this court, in order for the bank to prevail in this action it must appear not only that the liabilities of a person, company, firms, etc., to the bank for money borrowed or permitted to exceed the prescribed limit, but that defendant, while a director, participated in or assented

> to the excessive loan or loans not through mere negligence but knowingly and in effect intentionally . . . with this qualification, that if he deliberately refrained from investigating that which it was his duty to investigate, any resulting violation of this statute must be regarded as 'in effect intentional,' . . . ."

[*Corsicana National Bank v. Johnson*, 251 U.S. 68, 71-72 (1919).]

In applying this standard the Circuit concluded that an intentional violation of Section 84 was established because Petitioners admitted they knew of the amount and stated purpose of each loan. (App. A, *infra*, p. 8.) However, in *Anderson v. Akers*, 9 F.Supp. 151 (D.C. Ky. 1934), a case relied upon by Respondent as explaining the nature of the required knowledge, it was held at pages 152-153:

> ". . . [T]he knowledge necessary to render any particular conduct a violation of any of these statutes . . . is knowledge of the facts constituting that conduct. . . ."

In applying this decision the "facts constituting that conduct" would be knowledge at the time of loan approval that the loan exceeded the bank's lending limits. The validity of this application is borne out by the following decisions where personal liability was imposed only because the directors in fact knew at the time the loans were approved that the loans exceeded the bank's lending limits: *Corsicana National Bank v. Johnson*, *supra*, 71-77 (1919) and *McRoberts v. Spaulding*, 32 F.2d 315 (1929).

These cases require Respondent to prove by substantial evidence that Petitioners when they approved the loans, were aware of the fact that the loans exceeded the bank's lending limits. Respondent did not do so. He relied only on the knowledge that is deemed to exist as a matter of law with regard to every loan approved by a director and to the

only basis for Petitioners' admissions: a director is deemed to know the amount and stated purpose of a loan he approves. If this imputed knowledge satisfies the intentional or knowing violation standard of Section 93, the standard has been replaced by a form of strict liability. Such a concept not only conflicts with the decisions in *Yates* and *Corsicana* and the other cases cited above, it also means the following prediction stated in *Yates* could become a reality:

> ". . . Under such a conception it might well be that prudent and responsible persons would decline to assume . . . the duties imposed by the statute because of the hazard of an uncertain pecuniary liability which the statute imposing the duty did not contemplate. . . ." [*Yates v. Jones National Bank, supra*, 206 U.S. at 179.]

Such a concept when applied to a fast moving and complicated commercial banking world exposes national bank directors to a personal liability that was not contemplated by Section 93 or this Court's interpretations thereof. Petitioners' case exemplifies the problem.

None of the loans in this case individually exceeded the bank's lending limits. Each loan was applied for, presented and considered on a separate, individual basis at different times during a five month period in 1979. This is not a case where Petitioners are simply claiming they did not read or hear as a single figure the total of the loans. Instead, the uncontradicted evidence is that Petitioners at the time they approved each loan believed the loans did not exceed the lending limits of the bank.

Since the intentional violation standard established by *Yates* and *Corsicana* requires something more that what was established by Respondent, a conflict exists between these cases and the Ninth Circuit which justifies the grant of certiorari, especially in light of the impact the outcome will

have on the nature and scope of a national bank director's liability. As far as Petitioners are concerned, the record shows that there was no evidence of Petitioners' knowledge of the fact that the loans in question exceeded the bank's lending limits at the time Petitioners approved the loans. Accordingly, all provisions of the Ninth Circuit's judgment and Respondent's order which impose personal liability on Petitioners or require them to indemnify the bank should be stricken.

Prohibiting Application of Collection Proceeds to Excess Loans Conflicts With Decision of Supreme Court.

The Circuit also held that Respondent's discretion to order Petitioners to take affirmative action to correct conditions resulting from a violation of Section 84,[4] permits Respondent to prohibit Petitioners from reducing their liability for the two excess loans by recoveries on those loans until the Lewis loan is repaid in full. (App. A, *infra*, p. 9.) Such action conflicts with *Corsicana*, 251 U.S. 87, which held that recoveries from borrowers on account of an excess loan would go in diminution of a director's personal liability for that loan.

Respondent refused to follow *Corsicana* in this case:

> "The Directors have cited the *Corsicana National Bank* case for the proposition that recoveries on the illegal loans must be applied to reduce the Directors' liability 'on those loans'. . . . While it is true that the court observed, at 251 U.S. 87, that 'whatever of value the bank recovered from the borrowers on account of the loan would go in diminution of damages' . . ., the observation related to a single loan, not to a series of loans with the first credit extension being legal. In

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[4]12 U.S.C. §1818(b)(1).

other words, this case did not address the question of whether recoveries should be applied to reduce directors' liability on an excess loan while an earlier, lawful loan to the same borrowers remains unpaid." (App. C, *infra*, p. 44, n.5.)

Even though it is well settled that principles of law established by this Court are binding on the Respondent as an administrative agency (*Moore's Federal Practice*, Vol. 18, §0.403 n. 30), a conflict exists between the Ninth Circuit and *Corsicana*, which creates a situation where directors of national banks must now decide which rule to follow in applying recoveries made on excess loans. Their dilemma is acute when: (a) separate loans are made in good faith over a period of time and not as a means of circumventing the bank's lending limits established by Section 84; and (b) collateral is pledged specifically for some of the loans made during that time and not others.

In view of both the number of directors involved in the many national banking associations throughout this country and the complex commercial loan transactions being structured today, this conflict between *Corsicana* and the Ninth Circuit must be resolved so that all directors will know which rule will govern their conduct in similar situations. Unless this occurs, directors relying in good faith on the business judgment rule and advice of the officers and counsel of the bank could easily be penalized for following the long established principle that in the absence of a statute or regulation, their duties and liabilities as bank directors would be regulated by the common law. [*Bowerman v. Hammer*, 250 U.S. 504, 510-511 (1918); *Hoehn v. Crews*, 144 F.2d 665 (1944), *aff'd Garber v. Crews*, 324 U.S. 200 (1944).]

Petitioners, in applying the loan recoveries, complied with the common law according to *Corsicana* and the ob-

ligations created by the standard commercial loan documents executed by the borrowers. At the time they acted there was no regulation or directive from Respondent indicating Petitioners should do otherwise. Respondent did not even announce or raise this new rule regarding the application of recoveries until he filed his post-hearing brief with the ALJ. Until then, Respondent simply directed Petitioners to reduce the two excess loans to conforming amounts. It is true that the Bank's president cautioned Petitioners that applying the recoveries to the two excess loans might be construed as a breach of their fiduciary duties. However, Petitioners had to also consider Respondent's command to reduce the two excess loans and this Court's decision in *Corsicana*. Petitioners elected to follow *Corsicana*.

Respondent in his decision was legislating to limit, distinguish, or eliminate the effect of the common law as set forth in *Corsicana*. As this Court stated in *Union Pac. R. Co. v. Laramie Stock Yards Co.*, 231 U.S. 190, 199 (1913), "the first rule of construction is that legislation must be considered as addressed to the future, not to the past . . . [and] a retrospective operation will not be given to a statute which interferes with antecedent rights . . . unless such be the unequivocal and inflexible import of the terms, and the manifest intention of the legislature." [1 Davis, Administrative Law Treatise §5.09 (1st Ed. 1958).]

In 1978 Congress had the opportunity to eliminate the effect of *Corsicana* when it amended Section 93 by dividing it into sections (a) and (b) and also amended Section 1818. It did not do so. Instead Congress simply gave Respondent some new remedies that were not previously available, such

as the assessment of civil money penalties.[5] Where a statute has been judicially construed for a period of sufficient duration to provide Congress with adequate opportunities to modify the statute and it has not done so, congressional inaction or silence in this context is persuasive evidence of its satisfaction with the judicial interpretation of the statute, especially when Congress has amended the statute in other respects. [*Missouri v. Ross*, 299 U.S. 72, 75 (1936); *United States v. Elgin, J. & E. R. Co.*, 298 U.S. 492, 500 (1935).] As applied in this case, by not changing the original language of Section 93 Congress may be deemed to be satisfied with *Corsicana*.

There is no question that Petitioners as directors were under a fiduciary duty to exercise their powers in good faith and with a view to the interests of the bank. But here, *Corsicana* permitted Petitioners to reduce their personal liability by applying the loan recoveries to the excess loans. No statute enforced or regulation enacted by Respondent told them otherwise. To create and apply an ex post facto rule that requires something quite different from what was required by *Corsicana* is unfair and an abuse of discretion especially when Petitioners' conduct complied with the holding in that case.

As Justice Cardoza once said:

> "What was once settled by a precedent will not be unsettled overnight, for certainty and uniformity are gains not lightly to be sacrificed. Above all this is true when honest men have shaped their conduct on the faith of the pronouncement." (Cardoza, *The Paradoxes of Legal Science*.)

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[5]For the legislative history and purpose of the 1978 amendment of Sections 93 and 1818 see 1978 U.S. Code Cong. and Adm. News p. 9223.

Since Petitioners have complied with *Corsicana*, a case followed by the Courts, Congress, and Respondent since 1919, it is unjustifiable to apply Respondent's new rule retroactively to penalize Petitioners for doing the same thing. Petitioners should be permitted to reduce their liability by the amount of the recoveries on the excess loans, leaving only the unpaid principal balance and accrued interest of the Fame Furniture loan as the extent of their personal liability.

Conclusion.

For these reasons, a writ of certiorari should be issued to review the judgment and opinion of the Ninth Circuit.

Respectfully submitted,

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